

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

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CONVERGYS CORPORATION,

Plaintiff/Counter-defendant,

vs.

FREEDOM WIRELESS, INC.,

Defendant/Counter-claimant.

02:06-CV-0644-LRH (GWF)

ORDER

Presently before the court is Plaintiff Convergys Corporation's ("Convergys") motion to dismiss, or in the alternative, stay the counterclaims filed against it by Defendant Freedom Wireless Incorporated ("Freedom") (#48¹). Freedom has filed an opposition (#59) to which Convergys has replied (#65). A hearing was held on September 11, 2006, with both parties attending.

LEGAL STANDARD FOR MOTION TO DISMISS

In considering a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), the court asks only whether the pleadings are sufficient to establish a claim, not whether the Plaintiff could find evidence to support the pleadings. *See e.g., Lee v. City of Los Angeles*, 250 F.3d 668, 688 (9th Cir. 2001) (noting that "factual challenges to a plaintiff's complaint have no bearing on the legal sufficiency of the allegations"). Therefore, for the purpose of the motion, the court accepts as true all material allegations in the complaint and construes those allegations in the light most favorable to the non-moving party. *NL Indus., Inc. v. Kaplan*, 792 F.2d 896, 898 (9th

¹ References to (#XX) refer to the court's docket.

1 Cir. 1986) (citing *North Star Int'l v. Arizona Corp. Comm'n*, 720 F.2d 578, 580 (9th Cir. 1983)).
2 Dismissal is warranted only if it appears to a certainty that the Plaintiff would not be entitled to
3 relief under any set of facts that could be proven. *Id.*

4 **FACTS AND PROCEDURAL HISTORY**

5 This case is primarily an arbitration matter being dealt with by the American Arbitration
6 Association. This court has motions pending before it based on Convergys' request for a
7 preliminary injunction filed in conjunction with its complaint (entitled "Complaint for Injunctive
8 Relief in Aid of Arbitration" (#1)). Convergys' complaint requests injunctive relief which (1)
9 precludes Freedom from terminating the Interim Agreement²; (2) prevents Freedom from
10 representing that the Interim Agreement has been terminated; (3) prohibits Freedom from
11 representing that Convergys lacks an exclusive license to Freedom's technology; and (4) stops
12 Freedom from taking any other action that would deprive Convergys of a meaningful remedy if it
13 prevailed in the pending arbitration proceedings.

14 In response to the complaint, Freedom filed an answer and counterclaims. While
15 Convergys' complaint sought injunctive relief in an attempt to maintain what Convergys
16 considers to be the status quo, Freedom's counterclaims sought declaratory relief in the form of
17 determinations by the court that (1) Freedom is entitled to terminate the Interim Agreement; (2)
18 Freedom may represent to third parties that the Interim Agreement has been terminated; (3)
19 Freedom may license its technology out to third parties; and (4) Freedom may represent to third
20 parties that Convergys' license is limited to certain parties listed in the Interim Agreement.

21 Convergys has now moved to dismiss the counterclaims brought by Freedom or, in the
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24 ² Convergys and Freedom attempted to enter into a licensing agreement involving
25 patented technology held by Freedom relating to prepaid wireless phone calls and the billing of
26 those calls. Apparently, the circumstances surrounding Convergys' business made a complete
27 agreement impractical at the time of negotiation. Accordingly, Convergys and Freedom entered
28 into a separate agreement, called the Interim Agreement, which set forth certain business
arrangements, provided for dispute resolution mechanisms during the completion of the licensing
agreement, and stated the parties' intent to enter into a final and binding licensing agreement.
The validity of this contract is not before the court at this time.

alternative, to stay those claims pending arbitration.

DISCUSSION

The pending motion presents two issues for the court's consideration³. First, whether Convergys waived its right to compel arbitration of the counterclaims. And second, if Convergys has not waived its right to compel arbitration, whether the court must allow the counterclaims because they assert that the underlying arbitration clause was induced by fraud. As will be discussed below, the court concludes both that Convergys has not waived its right to compel the counterclaims to arbitration and that the counterclaims may be so compelled because Freedom did not properly plead its fraud argument.

1. Right to Compel Arbitration

Freedom contends that Convergys' complaint involves arbitrable issues and that the filing of the complaint necessarily waives Convergys' ability to compel arbitration of Freedom's counterclaims. The parties agree that three factors must be met for a party to waive its right to arbitration: (1) the party must know of an existing right to compel arbitration; (2) the party must engage in acts inconsistent with that right; and (3) the party opposing arbitration must suffer prejudice as a result of the inconsistent acts. *Brown v. Dillard's, Inc.*, 430 F.3d 1004, 1012 (9th Cir. 2005); *Fisher v. A.G. Becker Paribas, Inc.*, 791 F.2d 691, 694 (9th Cir. 1986). A finding that a contractual right to arbitration has been waived is not favored. Accordingly, "any party arguing waiver of arbitration bears a heavy burden of proof." *Fisher*, 791 F.2d at 694 (quoting *Belke v. Merrill Lynch, Pierce, Fenner & Smith*, 693 F.2d 1023, 1025 (11th Cir. 1982)). Convergys does not contest its knowledge of the right to compel arbitration under the parties'

³ The parties have also disputed whether the court may consider an agreement concerning arbitration made between the parties after the filing of the pending lawsuit. Documents outside of the pleadings may be considered by a court if its contents are alleged in the pleadings, are crucial to a party's claims, and none of the parties question the document's authenticity. *Sosa v. DIRECTV, Inc.*, 437 F.3d 923, 927 n.1 (9th Cir. 2006). In the present case, the subsequent agreement to arbitrate certain issues is neither alleged in the pleadings nor crucial to Freedom's claims. As such, the agreement is excluded from consideration at the motion to dismiss stage and has not been considered by the court.

1 previous agreements.

2 The parties dispute whether Convergys has acted in a manner inconsistent with its right to
3 compel arbitration. Based on the timing of Convergys' actions and the discussion of similar
4 issues in *PMS Distributing Company v. Huber & Suhner, A.G.*, 863 F.2d 639 (9th Cir. 1988), the
5 court concludes that Convergys' actions are not inconsistent with its right to compel arbitration
6 of the counterclaims.

7 In the standard case where a party is deemed to have waived their right to arbitration, a
8 wholly different factual scenario usually exists. In those cases, a party repudiates an arbitration
9 agreement in order to bring certain claims before the court. However, when counterclaims are
10 brought, the party that initiated the lawsuit seeks to compel arbitration of the counterclaims. In
11 the present case, Convergys initially sought to compel arbitration. After an arbitration demand
12 was filed, Freedom provided notice to Convergys that it considered the Interim Agreement in
13 place between the parties to be breached and expressed its intent to terminate the agreement.
14 Convergys then turned to the courts seeking the underlying preliminary injunction because no
15 arbiter had yet been assigned to the arbitration claims. Accordingly, the court does not view the
16 present case as one wherein the standard reasons for finding a waiver of the right to compel
17 arbitration would exist.

18 Further, the court notes the discussion found in *PMS Distributing*. In that case, the Ninth
19 Circuit was faced with a situation where arbitration had been compelled but one of the parties
20 had returned to the district court to seek a writ of possession. Citing to decisions from the First,
21 Second, and Seventh Circuits, the Ninth Circuit determined that the district court had authority to
22 issue the writ of possession based on the district court's original order to compel arbitration.
23 *PMS Distributing*, 863 F.2d at 641-42. While the basis for permitting the writ in *PMS*
24 *Distributing*, a previous order to compel arbitration, does not exist in this matter, the tacit
25 approval of the First Circuit decision in *Teradyne, Inc. v. Mostek Corp.*, 797 F.2d 43 (1986),
26 contained within the opinion, convinces the court that preliminary injunction requests in
27 arbitrable disputes are not inconsistent with the right to compel arbitration of claims. Called the
28 case "most similar factually" to *PMS Distributing*, 863 F.2d at 641, *Teradyne* held that a district

1 court can grant injunctive relief in arbitrable disputes which are pending arbitration so long as the
2 prerequisites for injunctive relief are satisfied. *Teradyne*, 797 F.2d at 51 (holding, after
3 summarizing the various position of the Circuit courts on this issue, that “a district court can
4 grant injunctive relief in an arbitrable dispute pending arbitration, provided the prerequisites for
5 injunctive relief are satisfied”).

6 The court has reviewed the cases discussed in *Teradyne*, as well as the underlying policy
7 arguments for and against allowing injunctive relief in arbitrable matters, and concludes that the
8 reasoning of *Teradyne* is sound. Accordingly, given that injunctive relief is available from
9 district courts in arbitrable matters, the court concludes that a request for injunctive relief is not
10 an act inconsistent with one’s right to compel arbitration.

11 The parties also dispute whether prejudice to Freedom would arise should the claims be
12 compelled to arbitration. Two forms of prejudice are recognized in these types of cases,
13 substantive prejudice and prejudice due to excessive cost and/or delay. *E.g., Thyseen, Inc. v.*
14 *Calypso Shipping Corp., S.A.*, 310 F.3d 102, 105 (2d Cir. 2002). The court has reviewed
15 Freedom’s arguments supporting the finding of prejudice and finds them unconvincing. The
16 court sees no potential for re-litigating claims should arbitration be compelled and none of the
17 costs associated with arbitration are excessive given that the litigation in this court only arose
18 after the arbitration claims were filed - precluding any argument that forcing arbitration will
19 unnecessarily increase the costs of litigation.

20 The court finds, therefore, that Convergys has not waived its right to compel arbitration
21 of the counterclaims brought by Freedom. Convergys has not acted in a manner inconsistent
22 with its known right to arbitrate and no prejudice will arise by compelling such arbitration.

23 2. *Allegations of Fraud*

24 Having concluded that Convergys has retained its right to compel arbitration of the
25 counterclaims brought by Freedom, the court is faced with Freedom’s argument that its
26 counterclaims should not be compelled to arbitration because the underlying agreement to
27 arbitrate was induced by fraud. Courts have the authority to determine whether an arbitration
28 clause was induced by fraud prior to compelling a matter to arbitration. *See Buckeye Check*

1 *Cashing Inc. v. Cardegna*, ___ U.S. ___, 126 S.Ct. 1204, 1208 (2006); *Three Valleys Mun.*
 2 *Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1140-41 (9th Cir. 1991). However, when
 3 “pleading to a preceding pleading, a party shall set forth affirmatively . . . fraud. . . .” Fed. R.
 4 Civ. P. 8(c). Further, when fraud is required to be pled, it must be pled with specificity. Fed. R.
 5 Civ. P. 9(b); *see also* 5A Wright and Miller, *Federal Practice & Procedure*, § 1297 at pp. 182-83
 6 (3d ed.2004) (noting that fraud must be raised as an affirmative defense, and that such a defense
 7 is an averment of fraud, subject to heightened pleading requirement).

8 Freedom’s answer and counterclaim are lacking in any allegations of fraud concerning its
 9 inducement into the arbitration clause of the Interim Agreement. The issue is raised, for the first
 10 time, only in Freedom’s opposition to Convergys’ motion to compel arbitration on Freedom’s
 11 counterclaims. The original complaint bases its request for injunctive relief on the assumption
 12 that a valid arbitration clause exists which would be rendered meaningless unless Convergys’
 13 view of the status quo is maintained pending arbitration. As such, Freedom was fully aware of
 14 the importance of the arbitration clause to the claim and cannot argue convincingly that adding
 15 specific allegations of fraud as an affirmative defense would have required it to predict
 16 Convergys’ future arguments. Accordingly, Freedom’s reliance on *Jacobson v. Schwarzenegger*,
 17 357 F.Supp.2d 1198, 1217 (C.D. Cal. 2004) (providing that parties need not anticipate and plead
 18 around affirmative defenses that might be raised in the answer), is misplaced.

19 As Freedom did not plead, with particularity, fraud in the inducement as an affirmative
 20 defense to the allegations that a valid arbitration clause existed which warranted injunctive relief,
 21 it would be improper to allow Freedom to raise those issues for the first time in its opposition to
 22 Convergys’ motion to compel arbitration.

23 3. *Federal Arbitration Act § 3*

24 Convergys has requested, as an alternative to dismissing Freedom’s counterclaims, that
 25 those claims be stayed pursuant to Federal Arbitration Act § 3, 9 U.S.C. § 3.⁴ As the court has
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27 ⁴ § 3 provides that “upon being satisfied that the issue involved in [a suit upon any issue
 28 referable to arbitration] is referable to arbitration . . . , [a court] shall on application of one of the

1 found that Convergys has not acted in a manner inconsistent with its right to arbitrate Freedom's
 2 counterclaims, those counterclaims are referable to arbitration. Further, the court notes that no
 3 evidence exists that Convergys is in default in the underlying arbitration. Under these
 4 circumstances, there remains much to be presented in the underlying arbitration and the court
 5 considers dismissal of Freedom's counterclaims without prejudice to be preferable.

6 CONCLUSION

7 The court finds that Convergys has not waived its right to compel arbitration in this
 8 matter. Further, the court concludes that Freedom may not raise the issue of fraud in the
 9 inducement at this stage because of its failure to plead the affirmative defense in its answer and
 10 counterclaim. Finally the court dismissed Freedom's pending counterclaims without prejudice.
 11 The court's order, however, should not be read to endorse Convergys' pending application for a
 12 preliminary injunction. The finding of a right to proceed in that matter does not imply a right to
 13 relief.

14 It is therefore ORDERED that Convergys' motion to dismiss, or in the alternative, stay
 15 the counterclaims (#48) is GRANTED.

16 Freedom's counterclaims are hereby dismissed without prejudice.

17 DATED this 11th day of October, 2006.



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 21 LARRY R. HICKS
 United States District Judge

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 27 _____
 28 parties stay the trial of the action until such arbitration has been had . . . , providing the applicant
 for the stay is not in default in proceeding with such arbitration." 9 U.S.C. § 3.